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BEFORE THE
**FEDERAL COMMUNICATIONS COMMISSION**
**Washington, D.C.**



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| In the Matter of | ) | |
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| **Amendment of Part 1 of the** | ) | |
| **Commission's Rules --** | ) | WT Docket No. 97-82 |
| **Competitive Bidding** | ) | |
| **Proceeding** | ) | |

TO: The Commission

# JOINT COMMENTS OF THE COALITION OF INSTITUTIONAL INVESTORS

Coalition Members:

Fleet Equity Partners
Media/Communications Partners
OneLiberty Ventures
Spectrum Equity Associates

Counsel:

Carl W. Northrop
E. Ashton Johnston
PAUL, HASTINGS, JANOFSKY
& WALKER LLP
1299 Pennsylvania Avenue, N.W.
Tenth Floor
Washington, D.C. 20004-2400
Its Attorneys

(202) 508-9570

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# JOINT COMMENTS OF THE COALITION OF INSTITUTIONAL INVESTORS

Fleet Equity Partners, Media/Communications Partners, OneLiberty Ventures, and Spectrum Equity Associates (collectively, the "Coalition of Institutional Investors"), by their attorneys and pursuant to Section 1.415 of the Commission's Rules,[1/] hereby jointly comment on the Notice of Proposed Rulemaking (the "Notice") portion of the decision released February 28, 1997 by the Commission in the captioned proceeding.[2/] The following is respectfully shown:

## I. INTRODUCTION

1. The members of the Coalition of Institutional Investors are venture capital firms or funds that have made substantial investments in and loans to enterprises engaged

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[1/] 47 C.F.R. § 1.415(b).

[2/] Order, Memorandum, Opinion and Order and Notice of Proposed Rulemaking, WT Docket No. 97-82, FCC 97-60, released February 28, 1997.

in telecommunications and media businesses. Collectively, members of the Coalition have more than $1.75 billion under management, of which over $1 billion is invested in, or earmarked for investments in,[3/] communications-related companies. Current investments span a broad cross-section of businesses within this sector, including personal communications services ("PCS"), cellular telephone, specialize mobile radio ("SMR"), radio paging, Wireless Communication Service, competitive local exchange service, competitive interexchange service, satellite services, internet companies, radio and television broadcasting, cable, and other new and emerging technologies.

2. The Coalition of Institutional Investors has a substantial basis in experience for informed comment in this proceeding. Members of the Coalition have invested in -- or actively explored investments in -- applicants in nearly every spectrum auction the Commission has conducted. In many instances, the Coalition members were among the original group of investors to join in the formation of a newly-created company to participate in a forthcoming auction. As a result, the Coalition members are intimately familiar with the practical and business implications of the

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[3/] In some instances the money under management is in an industry sector fund that is designated solely for communications-related investments.

control group, attribution, affiliation, bidding and other rules that governed prior auctions.

**EXECUTIVE SUMMARY**

3. Based upon the wealth of experience of its members in prior auction proceedings, the Coalition strongly endorses the conclusions that (i) the auction rules must be simplified, (ii) the auction procedures must be streamlined, and (iii) in several respects the rules need to be clarified. The overall objective of the Commission should be to refine and streamline the rules so that communications companies can adopt rational business structures and attract capital.

4. The Coalition is filing a comprehensive set of comments that addresses the full range of questions posed by the Commission in the Notice. There are, however, issues of particular concern to the financial community that deserve to be highlighted. First, in most prior instances, the definition of the "affiliates" of an applicant used in prior auctions was overly expansive. The result was the inclusion in calculations of gross revenues for size determination purposes of remote financial resources that were not available to the applicant. This must be changed. See discussion infra at pp. 7-9. Second, the "control group" structures adopted in many prior auctions were needlessly complicated, and forced some entrepreneurs to adopt cumbersome organizational structures that were not

well-suited to the entrepreneurial nature of spectrum-based businesses. The regulatory constraints also resulted in some convoluted ownership structures in which the interests of participants began to diverge from their financial or operational stakes in the enterprise. Simplification of these rules will serve the public interest. See discussion infra at pp. 6-7. Third, overly broad anti-collusion rules had a chilling effect on legitimate business communications that posed no threat to the integrity of the auction process. The result was the discouragement of transactions that would indeed have served the public interest. These restrictions must be relaxed. See discussion infra at pp. 18-20.

5. In sum, the Coalition of Institutional Investors applauds the Commission's effort to undertake a comprehensive examination of the competitive bidding rules based upon the experience garnered to date in the auction process. The following comments are intended to assist the Commission in this process.

## II. COMMENTS

### A. Applicability of General Competitive Bidding Rules

6. The Notice proposes that the general auction rules adopted in this proceeding shall govern all future auctions, including further auctions and reauctions in services in which prior auctions have already been

conducted.[4/] The Coalition agrees. Valuable experience has been gained in the course of prior auctions that enables the rules to be refined and improved. No public interest benefit would be served by locking some services into historical procedures based upon the happenstance that the first auction in the service already has taken place.

7. The Coalition of Institutional Investors also agrees that the general rules adopted in this proceeding should supersede all inconsistent service-specific rules, including rules in pending proceedings. However, the Commission must take pains to clearly identify the superseded rules so that there is no confusion regarding the applicable standards. For each previously licensed service -- and each unauctioned service where specific auction rules already have been adopted -- the Commission should issue an index of any service-specific auction rules that continue in force and effect.[5/] The Commission also should make clear that it will favorably consider requests from incumbent licensees who wish to conform their business structures to

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[4/] Notice, ¶ 18. In certain instances, some but not all of the licenses in a particular service have been auctioned (e.g., narrowband PCS). In others, licenses will be reauctioned following defaults (e.g., broadband PCS).

[5/] For example, the market area licensing rules for paging services recently adopted in the Second Report and Order and Further Notice of Proposed Rulemaking, WT Docket No. 96-118, FCC 97-59, released February 24, 1997, include special stopping rules that are tailored to the paging service, and should survive the adoption of generic auction rules.

the new rules. For example, because so many wireless services are competitive substitutes for one another, it would violate principles of competitive neutrality to force an existing small business licensee to maintain a restrictive "control group" ownership structure while potential competitors can adopt a more streamlined and flexible approach.

B. Rules Governing Designated Entities

8. In its good faith effort to adopt comprehensive measures to assure that designated entities ("DEs") comply with applicable size and control standards, the Commission ended up with an overly complex set of regulations that acts as a deterrent to investment. The public interest will be served by simplifying some of the rules governing DEs.

9. Most important, the Commission should substitute a simple de facto and de jure control test for the complicated "control group" structures that now appear in certain rules.[6/] Artificial requirements that certain participants retain pre-ordained minimum voting and equity percentages reduce flexibility and result in deal structures which are needlessly complex.

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[6/] Notice, ¶ 28.

10. A uniform definition of gross revenues should be adopted for use in determining the size of DEs.[7/] Applicants should be able to use either fiscal year or calendar year statements for calculation purposes to ease the gathering of the requisite information. Because so many spectrum applicants are newly created entities, audited financials should not be required.

11. The Coalition also supports the Commission proposal to set size standards on a service-by-service basis,[8/] taking into consideration the capital requirements of each. In the process, care should be taken to avoid changes in the standards that would cause competitive disparity.[9/]

C. Attribution and Affiliation Rules

12. Several changes in the attribution rules are essential to avoid including in the calculation of gross revenues remote financial resources that are not available to the applicant. For purposes of determining what investor revenues are attributable to an applicant, the Commission requires that "affiliate" revenues be included. At present, the affiliation rules contain so extensive a list of

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[7/] Notice, ¶ 23.

[8/] Notice, ¶ 20.

[9/] For example, recaptured and reauctioned licenses should be subject to the same size standards as earlier licensed channels in the same service to avoid creating market inequalities.

possible bases of affiliation (e.g., officer and directorships, key management positions, familial relations, common investments, common management, common facilities, etc.)[10/] that virtually any entity with a relation to the applicant could be deemed an affiliate. This overinclusiveness creates a situation in which the calculation of gross revenues has no meaningful relationship to the true financial wherewithal of the applicant.

13. The affiliation rules are particularly harsh as applied to institutional investors. Often the same money managers will direct multiple funds that are devoted to distinct investments. And, some funds are subject to strict limits on the percentage of a fund or group of funds that can be devoted to a single investment. Nevertheless, under the "common management" test, these related funds would all be deemed "affiliates" and 100% of the revenues generated by the funds would be reportable as revenues of the applicant. Indeed, a mature, fully-invested fund that has no money in the applicant, and no money to provide the applicant, would nevertheless have its revenue counted against the size limits of an "affiliated" fund which had an attributable investment in the applicant.[11/]

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[10/] See, e.g., 47 C.F.R. § 1.2110(b)(4).

[11/] This is not merely a theoretical problem. A request by one Block F PCS applicant for a waiver to exclude the revenues of mature venture capital funds affiliated with one (continued...)

14. On balance, the public interest will be served by including in the size determination the gross revenues only of controlling principals of the applicant. In the case of institutional investors, the revenues of an affiliate of an institutional investor should be excludable from the calculation of gross revenues if the applicant and the institutional investor certify that money from the affiliate is not and will not be available to the applicant.

D. Installment Payments

15. The Notice asks whether changes should be made to the installment payment program.[12/] The Coalition of Institutional Investors know that the favorable installment payment terms that have been available to DEs have been a major factor enabling entrepreneurs to attract capital. While some steps can be taken to reduce the risks of default, wholesale changes in the installment payment program should not be adopted.

16. Specifically, the Coalition opposes having the Commission abandon the installment plan in favor of larger bidding credits. As the Commission is aware, in many instances DEs ended up bidding away their credits against

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[11/] (...continued)
of its attributable venture capital investors was denied by the Commission. See Letter from K. O'Brien-Ham, Chief, Auctions Division, to Mr. Barry B. Lewis, Triad Cellular Corporation, August 19, 1996 (DA 96-1403).

[12/] Notice, ¶¶ 32-38.

non-DE participants.[13] Abandoning the installment payment plan could, under such a scenario, make the DE preference totally illusory.

17. Nor should the Commission require larger down payments.[14] Down payments on loans are generally designed to protect the lender against reductions in the value of depreciable assets that are being financed. In this instance, upon default the Commission will recapture the exact spectrum rights it had to start with. Consequently, there is no economic basis for increasing the down payment.[15]

18. There are, however, some prudent steps the Commission can take to reduce the risk of default by applicants using an installment payment plan. First, the Coalition supports the idea that bidders be required to increase their upfront payments to maintain a certain minimum ratio between the money the applicant has on deposit and the cumulative bids that are outstanding. This will reduce speculation. The Coalition recommends that, whenever an applicant's deposit drops below 4% of its high bid

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[13] For example, DE bidders for certain regional narrowband PCS channels used up their credit by bidding higher amounts than their non-DE counterparts bid for comparable spectrum.

[14] Notice, ¶ 35.

[15] Of course, the recaptured spectrum rights may have a different value, but the Communications Act makes clear that auction rules are not intended to be designed solely to maximize revenues. 47 U.S.C. § 309(j)(7).

amounts, it be accorded 10 business days to bring its deposit up to 6%[16] of the high bid total that triggered the supplemental payment obligation.[17]

19. The Coalition does not favor having the Commission try to screen applicants for creditworthiness.[18] Prior experience with Commission financial qualification standards, particularly in the cellular arena, demonstrates that paper showings of this nature are of limited value and foster litigation. The better course is for the Commission to retain meaningful upfront payment, down payment, and default rules, and to enforce them strictly.

20. It does appear to the Coalition that upfront payments would be a much more meaningful safeguard if a separate upfront payment was required on each license for which an applicant wished to be qualified to bid. This also would reduce the number of "phantom" mutual exclusivities (i.e., the theoretical frequency conflicts caused by the fact that the current auction rules create no financial

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[16] Generally, the Commission has established upfront payment obligations based upon an estimated 5% of bid price. Having a 4%-6% collar on the supplemental payment obligation provides a reasonable payment range.

[17] Supplemental upfront payments would not be refundable until the auction was concluded, or the applicant dropped out. Otherwise, the payment and refund procedures would become too complicated.

[18] Notice, ¶ 23.

disincentive to list licenses in an application on which the applicant has no bona fide intention to bid).

E. Payment Terms

21. The Coalition favors retaining the T-note rate as the base rate on which interest payment terms are calculated because it provides an objective measure of the Government's cost of money. Using the coupon rate of interest offered in the most recent Treasury auction preceding the close of the Commission's auction makes sense, as this will enable bidders to readily determine the base in the course of their bidding. The sliding scale of discounts set forth in paragraph 36 of the Notice is reasonable.

22. The Coalition does not support the substitution of a more "market based rate" with a cost of funds component or credit risk premium. The favorable interest rates that derive from the use of the T-note rate as the base have been a major factor in enabling DEs to attract capital. Removing these benefits would significantly impair the realization of the statutory objective of ensuring the meaningful participation of DEs in spectrum-based businesses.

23. Steps should be taken to assure that all winners in the same auction are subject to the same base rate, and that their payments are due at the same time, without regard to when the Commission actually gets around

to formally granting their underlying application.[19/] The current situation -- in which challenged applicants enjoy a deferral in their down payment deadline, or end up with a different base rate of interest due to a superseding T-note auction -- creates perverse inequities.

F. Bidding Credits

24. The Coalition supports the Commission's proposal to standardize the sliding scale of bidding credits that is available to an applicant based upon applicant size, as set forth in the table in paragraph 39 of the Notice. Having businesses of equal size receive different levels of bidding credit in different services threatens to skew the incentives to participate in a manner that extends beyond the Commission's charge.

G. Unjust Enrichment

25. As a general rule, the Coalition disfavors rules that interfere with the free alienation of licenses. The communications marketplace is very dynamic, but can only work effectively if the Commission does not impose restrictions on assignments and transfers that interfere with the principle that licenses should end up in the hands of those who value them most highly.

26. The Coalition recommends that the unjust enrichment rules be limited to those situations in which the

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[19/] Notice, ¶¶ 38, 65.

assignor/transferor has not completed construction to the point where "substantial service" is being provided to the public within the licensed service area.[20/] Thereafter, licenses should be freely transferable without imposition of an unjust enrichment assessment.

H. Ownership Disclosure Requirements

27. The Commission proposes to maintain the requirement that auction applicants submit detailed ownership information, and suggests that the 5% ownership threshold that is used in several services be codified in the general auction rules.[21/] In the view of the Coalition, less information is necessary in the short-form application (FCC Form 175). The objective of the Commission to solicit sufficient information to ensure compliance with the rules governing DE status, spectrum caps and other ownership limits would be fully satisfied by deferring the filing of comprehensive ownership formation until the long-form application is due. The initial application could then be limited to information regarding attributable investors and, perhaps, key management personnel. For this purpose, the Coalition recommends that the Commission adopt a general auction rule which incorporates the 25% attribution limit

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[20/] Service-by-service construction standards could be adopted to prevent licensees from building skeletal systems merely to permit an assignment or transfer.

[21/] Notice, ¶¶ 44-52.

which now appears in Section 24.720(j) of the rules. As a consequence, holders of less than 25% of the interests of an applicant would not have to be listed on the FCC Form 175, unless they were in a position of control by virtue of other arrangements (voting agreements, management structure, etc.). This would reduce paperwork and the burden of preparing and filing applications.

28. Whatever the final reporting requirement, the Coalition favors the establishment of a central database of licensee, bidder, and attributable investor information.[22/] The Commission also should allow applicants to cross-reference other applications where information about a specific investor already has been disclosed. Due to the number of applicants and investors that show up repeatedly in successive auctions, such procedures would serve to streamline the filings.

I. Refunds of Upfront Payments

29. Because it is impossible to predict both the outcome of auctions and their likely duration, it is important to institutional investors that their money not be tied up indefinitely if and when an applicant they are backing drops out of an auction. Consequently, the Coalition favors the continuation of the practice of

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[22/] Notice, ¶ 54.

allowing bidders who drop out prior to the close of an auction to apply for an immediate refund.[23/]

J. Late Fees

30. It makes sense for the Commission, like a commercial lender, to make some provisions for late payments with a late payment penalty. The proposals to make the grace period short (10 business days) and the penalty relatively high (5% of the amount due) are reasonable.[24/] The Coalition also supports the simplification of the grace period procedures specified in paragraph 74 of the Notice. As the Commission recognizes, knowing in advance the nature and extent of the relief that will be forthcoming from the Commission to a licensee who misses an installment payment will assist the licensee in implementing a comprehensive solution to financial pressures.

K. Defaults

31. As a general rule, the Coalition of Institution Investors is of the view that strict default penalties must be maintained and enforced to reduce any inclination of prospective applicants to speculate on licenses. Consequently, the Coalition endorses the tentative conclusion to subject licensees who make down

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[23/] Notice, ¶ 57.

[24/] Notice, ¶ 70.

payments but default on installment payments to a default penalty.[25/]

32. Generally, the Coalition urges the Commission to avoid waiving default penalties or restructuring the debt of winning applicants who experience financial distress. Speculation in future auctions will become rampant if prospective bidders believe that payment obligations will not be strictly enforced. It also is unfair to bidders and licensees who honor payment obligations if competitors with a failed business plan are given extraordinary relief.

L. Real-Time Bidding

33. Conceptually, real-time bidding[26/] seems to hold promise of expediting auction processes. In practice, however, implementing this idea would have many negative implications. Monitoring bidding developments would present an overwhelming challenge if bidding was allowed on a continuous basis. Rational, economically-based bidding depends upon the ability of participants to receive and assimilate information concerning other bids. As the number of licenses that is in play in a single auction increases, the use of real-time bidding poses a real threat to the achievement of rational market-based results.

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[25/] Notice, ¶ 77.

[26/] Notice, ¶¶ 79-84.

M. Minimum Opening Bids

34. The Commission's auction authority only extends to mutually exclusive applications.[27/] The Commission has stretched its auction authority to or beyond the limit by drafting rules which make it easy and strategically beneficial for a potential bidder to mark the "All" box on the FCC Form 175, thereby creating what are in fact only theoretical frequency conflicts. If a bidder were then required to submit a minimum opening bid on a license that is in the auction purely as a result of this "phantom" mutual exclusivity, the Commission will effectively have auctioned off a channel that was not of serious interest to more than one party. The Commission should avoid this unwarranted extension of its auction authority by retaining the current policy of allowing bidders to place token bids (e.g., $1.00) on licenses.

N. Anti-Collusion Rules

35. In their present form, the anti-collusion rules are unduly restrictive. A series of problems exist. First, defining any 5% or greater interestholder (and their affiliates) as the "applicant" for collusion rule purposes serves to place expansive restrictions on investors and individuals who are likely to have only a casual involvement in the auction process. Second, the rules have a

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[27/] 47 U.S.C. ¶ 309(j)(1).

significant chilling effect on legitimate business discussions between companies that have business dealings other than on their respective auction applications. In this dynamic telecommunications marketplace, there is a very real possibility that merger and acquisition discussions will be taking place between two incumbent operators who also happen to have pending spectrum auction applications that are merely incidental to their core business. Consequently, the Coalition strongly supports the "safe harbor" discussed at paragraph 102 of the Notice.

36. Most important, the Coalition seeks enlightened anti-collusion rules that will facilitate investments by institutional investors in multiple applicants. As the Commission properly recognizes, investors are reluctant to put money into an enterprise if they are unable to receive information concerning the activities of the company. Yet, an institutional investor that holds a 5% or greater investment in two auction participants risks violating the anti-collusion rules if it seeks to keep abreast of the bidding developments of multiple bidders. The answer is for the anti-collusion rules to distinguish the receipt of bidding information, from the imparting of bidding information. Non-controlling interestholders should be able to receive bidding strategy information from multiple applicants without implicating the anti-collusion rules, provided that the common investor

certifies that it has not communicated and will not communicate confidential bid information from one applicant to another. In this regard, the act of voting to approve or disapprove a particular bid or bid strategy for one applicant would not be deemed to communicate bids or bid strategy of the other applicant.

37. Finally, the members of the Coalition heartily endorse the proposal to enable an investor in an applicant who has dropped out of an auction to invest in another surviving applicant if there has been no prior communication of bids and bid strategies between the applicants.[28/] This exception would address the concern that an institutional investor often has no ability to cause an applicant to stay in an auction, and thus should retain the ability to "pick a new horse" in any auction in which the investor remains interested in participating.

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[28/] Notice, ¶ 101.

## CONCLUSION

The foregoing premises having been duly considered, the Coalition of Institutional Investors respectfully requests that the Commission adopt general auction rules as set forth in these Comments.

Respectfully submitted,

**Fleet Equity Partners**
**Media/Communications Partners**
**OneLiberty Ventures**
**Spectrum Equity Associates**

Carl W. Northrop
E. Ashton Johnston
PAUL, HASTINGS, JANOFSKY
& WALKER LLP
1299 Pennsylvania Avenue, N.W.
Tenth Floor
Washington, D.C. 20004-2400
Its Attorneys
(202) 508-9570

March 27, 1997

**CERTIFICATE OF SERVICE**

I, Yvette Omar, a secretary with the law firm of Paul, Hastings, Janofsky & Walker LLP, hereby certify that a copy of the foregoing **Joint Comments of the Coalition of Institutional Investors**, was sent via first class U.S. mail, postage prepaid, or hand-delivered on this 27th day of March, 1997, to the following:

Kathleen O'Brien-Ham
Chief, Auctions Division
Wireless Telecommunications Bureau
Federal Communications Commission
2025 M Street, N.W., Room 5322
Washington, D.C. 20554

Dan Phythyon
Chief, Wireless Telecommunications Bureau
Federal Communications Commission
2025 M Street, N.W., Room 5002
Washington, D.C. 20554

Gerald P. Vaughan
Deputy Bureau Chief
Wireless Telecommunications Bureau
2025 M Street, N.W., Room 5002
Washington, D.C. 20554

Karen Gulick
Assistant Bureau Chief
Wireless Telecommunications Bureau
2025 M Street, N.W., Room 5002
Washington, D.C. 20554

Yvette Omar